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19 February 1974

MEMORANDUM FOR: Mr. Charles L. MacDonald
OASIA/ED
Room 5211
Department of the Treasury

SUBJECT: Impact of Higher Oil Prices on
South America

In response to your request of 14 February 1974,
attached is information on the impact of higher oil prices
on South America. If you have further questions, you may
contact

Chief
Latin America Branch, OER

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Attachment:
As stated

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Impact of Higher Oil Prices on South America

1. The impact of higher oil costs on South American countries in 1974 will vary. Growth and price stability will be impeded in some countries. Export earnings will rise sharply for others. Brazil, Chile, Paraguay, and Uruguay -- countries largely dependent on foreign oil supplies -- will suffer most. Argentina, Colombia, and Peru, which produce most of their own requirements, will be only moderately affected. Bolivia, Ecuador, and Venezuela, net exporters of oil, will gain substantially from higher foreign exchange earnings and increased royalty and tax payments by oil companies.

2. Except for the petroleum exporting countries, growth rates in 1974 are likely to fall. Even countries which are relatively self-sufficient will suffer some adverse impact of higher oil prices. Many imports, particularly petroleum-based products, will be more expensive. International demand for raw material and manufactured exports will fall if the sharp rise in oil prices slows growth in developed countries. Inflationary pressures will probably intensify and government measures to counter them will moderate economic growth policies.

3. If higher prices prevent maintenance or expansion of oil imports, economic growth will be further reduced. Petroleum consumption has risen steadily in the region, at

rates ranging from 8% for Colombia to 12% for Brazil. Because much of the region's electric power and transport media are fueled by oil, growth in industrial output is likely to slow and transportation may be disrupted. Few readily available substitute energy sources exist.

Countries Largely Dependent on Foreign Sources

4. The oil import bill for Brazil, Chile, Paraguay, and Uruguay could reach \$2.7 billion during 1974, equal to about 30% of their export receipts. Brazil would account for an estimated \$2.2 billion and Chile nearly all the remainder. Imports to Paraguay and Uruguay are small. Brazil's projected oil imports will cost about 30% of projected export earnings and Chile's about 23%. Uruguay's imports will equal about 45% of export earnings. Because Paraguay's requirements are small, oil imports may be less than 10% of projected export earnings. Brazil's strong reserve position and export capability will enable it to absorb the higher oil import costs. In contrast, higher oil prices will have a particularly detrimental effect on the economies of Chile and Uruguay because they must import other critical food and raw materials as well and their export industries will not be able to expand revenues sufficiently to match rising import costs.

Balance of Payments in 1973

5. While some countries profited considerably from high commodity prices in 1973, internal economic policies

denied these gains to others. Brazil, for instance, had a favorable balance of payments during 1973. Exports grew rapidly as world demand for food and raw materials remained high and Brazil expanded its sale of manufactured exports as well. Exports receipts jumped to \$6 billion, some 50% over 1972. Large capital inflows, including substantial direct foreign investment, more than offset the \$1.4 billion current account deficit. Consequently, gold and foreign exchange reserves rose by \$2.1 billion to \$6.3 billion at the end of 1973.

6. On the other hand, Chile's already weak foreign exchange position deteriorated further, although some improvement occurred late in the year. Despite record world market prices for Chile's major export, copper, it registered a large balance of payments deficit. Mining and agricultural production had fallen. While higher prices offset much of the drop in copper export volume, massive imports of food and other goods were necessary to sustain minimum requirements. Although the balance of payments improved slightly during the last months of the year, the deficit still totaled \$255 million. This substantial improvement over the previous year's payments deficit of \$900 million resulted from the increased copper exports, large foreign credits, and suspension of payments on Chile's \$4 billion foreign debt. Net foreign exchange reserves declined further from a minus \$290 million to minus \$450 million.

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7. Uruguay and Paraguay both benefited greatly from higher prices for agricultural products. Uruguay's exports grew 52% in 1973, reaching \$300 million. To prevent a substantial payments deficit, however, it was necessary to curtail imports, to restrict capital movements, and to sell official gold holdings on the free market. Net foreign exchange reserves thus were maintained at minus \$20 million. Paraguay's foreign exchange reserves rose some 40% to \$43 million during 1973, largely reflecting an estimated trade surplus of \$21 million which offset small capital outflows.

Impact of Higher Oil Prices on the Balance of Payments,
1974

8. Higher import costs will significantly affect the balance of payments of each of these oil importing countries in 1974. In contrast to 1973's \$2 billion surplus, Brazil's balance of payments will probably swing to a small deficit. Higher oil import costs, and expected increases in other imports could boost the bill to more than \$9 billion. Export growth, however, is likely to slow and export earnings probably will be about \$7 billion. Moreover, capital inflows may fall somewhat. Brasilia apparently is willing to accept a moderate drawdown in Brazil's \$6 billion foreign exchange reserves in order to maintain economic growth.

9. Chile is less able to absorb the oil price increases. Imports, including essential foodstuffs, spare parts, raw materials, and petroleum, may reach \$2 billion. Although

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copper production may rise some 25% above last year's level, export earnings probably will not be sufficient to pay for the increased imports. Moreover, expansion of exports would be slowed if demand for copper falls because of declining growth in developed countries. Continued substantial large lines of credit and a renegotiation of Chile's massive payments on its foreign debt are required to avoid a substantial increase in Chile's balance of payments deficit.

10. Paraguay should be able to finance its increased import bill with higher export earnings and drawing on its foreign exchange reserves. Uruguay will have difficulty paying for its imports. Montevideo has been forced to keep imports within current export earnings in recent years because of the country's foreign reserve position, its substantial commercial arrears, and poor international credit rating. Although exports may reach an estimated \$325 million, 45% of it will go to pay for oil imports. Such payments would require a substantial cutback in Uruguay's other imports -- largely raw materials and intermediate goods for local industry.

Growth and Inflation in 1974

11. Economic growth rates in oil importing countries will probably be slowed by high oil prices. Growth in Brazil's GNP may be only 8%-9% rather than the 11% average of the

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past two years. High oil import costs probably will cause some reduction in the amount of raw materials and intermediate goods imported. Government measures to contain inflation also will slow economic growth.

12. Chile's economy is expected to grow an estimated 3%-5%, but may do no better than 2%-4%. More rapid expansion will be dampened by high oil costs and the likely slower growth in developed countries' demand for copper. Moreover, the junta's measures to reduce inflation from more than 500% to about 100% may also restrict expansion. Growth in Uruguay's GDP also should drop an estimated 2%-4%.

Countries Supply Most of Their Own Petroleum

13. The impact of higher oil prices in 1974 on Argentina, Colombia, and Peru will be moderate. The oil import bill could reach \$745 million, about 13% of projected export earnings for the year. Argentina accounts for 65% and Colombia and Peru share the balance. The countries should be able to absorb the higher import costs. Argentina's balance of payments position is expected to deteriorate as higher oil prices are felt both directly and in higher prices for imported intermediate goods. Colombia is expected to maintain a strong balance of payments position, while Peru's substantial foreign exchange reserves should cushion the impact of a higher import bill. Peru's economy, however, probably will suffer some adverse impact from the higher costs.

Balance of Payments in 1973

14. Argentina and Colombia benefited considerably in 1973 from the sharp rise in agricultural export prices. The combination of higher prices and increased grain production boosted Argentina's exports by more than 40% to some \$2.8 billion. The resulting trade surplus of an estimated \$600 million, however, was largely offset by substantial services payments. The resulting small current account surplus was supplemented by a sharp growth in short term capital inflows nearly doubling gross foreign exchange reserves to \$1.2 billion, while shifting net reserves to a slightly positive position. Colombia's net foreign reserves jumped by nearly 50% to \$480 million, reflecting a small trade surplus and substantial capital inflows.

15. Peru, on the other hand, experienced a substantial trade deficit. Exports were low because of the loss in fishmeal exports, while imports continued to rise. However, large foreign direct investments in mining and petroleum, and substantial public sector credits boosted foreign exchange reserves 34% to \$584 million.

Impact on the Balance of Payments, 1974

16. Argentina expects to import about 15% of oil needs in 1974 at a cost of up to \$500. Even with its increased oil costs, however, Argentina is likely to have about a \$300 million trade surplus. If service payments are kept at last

year's level and capital inflows are improved, ...
Argentina could keep its 1974 payments deficit
to about \$50 million.

17. Colombia is essentially self-sufficient in oil, but must import some refined products. Domestic output has been falling in recent years and exports are being curtailed. Thus, estimated net oil imports in 1974 of about \$100 million, will equal less than 10% of 1974's export earnings. A continuation of Colombia's strong export performance is likely to keep the direct impact of high petroleum prices minimal permitting another balance of payments surplus in 1974.

18. Higher oil prices could swing Peru's balance of payments into a deficit. Although some recovery in fishmeal exports and price increases for petroleum, silver, and zinc might increase export earnings by 20%, a higher import bill probably will generate another trade deficit. Moreover, debt service payments equivalent to about 25% of projected 1974 export earnings will contribute to a substantial current account deficit. Capital inflows are expected to be lower, resulting in a small balance of payments deficit and causing a drop in reserves. Because maintenance of import levels is essential for continued economic growth, Lima probably will draw down reserves to sustain imports.

Economic Growth and Inflation in 1974

19. Economic activity in these countries should expand in 1974, albeit at rates below those previously anticipated. Argentina's growth rate -- spurred by high exports of both agricultural and manufactured goods should be near last year's 4%. Higher oil import costs will intensify inflationary pressures, and increase the current squeeze on profits. Selective revaluation of the peso has been promised to counter the rising prices for imports. While these measures may preserve the government's tight price and wage controls and hold cost of living increases to less than 15%, shortages of goods and sluggish growth may characterize the economy in 1974.

20. Colombia's growth rate could be adversely affected. The economy has grown rapidly in recent years' 1973 real GNP increased 7.5%. This expansion was spurred by rising manufacturing output and booming exports. In 1974, rapid economic growth is expected to be slowed largely by the impact of higher oil prices. Shortages in raw materials and supplies, stagnating export prices, and intensified inflationary pressures all will be contributing factors.

21. Peru's economy is expected to grow at a somewhat slower rate than 1973's 5%. Although construction should continue at a rapid pace because of large public investments, fishing output is likely to remain far below the normal level and the growth of manufacturing and mining will slow. Shortages of petroleum based raw materials such as synthetic fibers for textiles will retard the use of recently-installed industrial capacity. Mining

may be affected by reduced international demand for non-ferrous metals by industrial countries with low growth rates. Inflationary pressures in Peru increased during the last few months of 1973, causing the cost of living to accelerate to 8%-10% for the year. Higher petroleum prices will intensify these inflationary pressures. 25X1

Argentina

26. Argentina's import bill for crude oil and refined products is expected to nearly triple to some \$500 million dollars in 1974, if President Peron aggressively pursues a recently announced development plan. This amount would represent roughly 16% of Argentina's projected export earnings. Argentina, however, should be able to absorb the increased oil costs without significant disruptions. Planners are calling for a one-third increase in oil imports in 1974 due to a continuing decline in domestic oil production and a projected growth in demand.

27. During 1973, Argentina's balance of payments showed dramatic improvement due to a recovery in grain production and record prices. Argentina's trade balance registered a surplus of roughly \$600 million as compared to \$36 million in 1972. The trade surplus offset the capital account deficit resulting in the first balance of payments surplus since 1970. Growing exports of manufactured goods and a favorable corn harvest should more than compensate for a fall in projected wheat exports during 1974 and boost export earnings to more than \$3 billion. Argentine debt payments and increased oil import bills in 1974, however, will be a drain on reserves easily negating official projections of another balance of payments surplus.

28. Besides the increased pressure on payments and foreign reserves in 1974, increased prices of imported petroleum and petroleum products will put added pressure on domestic prices, profits, and government deficits. If Buenos Aires continues to hold a tight rein on wages and prices, increased costs of petroleum imports will further cut depressed corporate profits and further dampen the already shakey investment climate. Argentina will then be forced to resort to more monetary expansion to finance its development program with the likely result that domestic shortages will increase, black market activity will widen, keeping the economy far below its potential.

29. Argentina's public external debt amounts to some \$3.2 billion dollars. Service payments in 1974 will total some \$600 million. As a result of this continuing drain on its payments, Argentina has expanded short term debt and is seeking new financing in world financial markets. The added burden of new debts incurred for development financing will be exacerbated by higher oil prices during 1974.

Argentina

Balance of Payments Summary

	Millions of US\$		
	<u>1972</u>	<u>1973</u> <u>Estimated</u>	<u>1974</u> <u>Projected</u>
Exports (f.o.b.)	1,940	2,985	3,200
Imports (c.i.f.)	-1,904	-2,115	-2,900
Petroleum	(50)	(190)	(500)
Trade balance	36	870	300
Services	-265	-280	-300
Current account balance	-229	590	300
Capital account balance	55	(
Short-term capital,		(
errors and omissions	-111	(
Net change in foreign exchange reserves (increase -)	+285	-670	-100

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Brazil

30. Brazil oil import bill during 1974 probably will exceed \$2 billion, about 30% of 1974's estimated export earnings. Brazil's strong foreign reserve position and export capability will enable it to absorb the increased burden and the impact on the domestic economy will be only moderate.

31. During the past two years, Brazil has enjoyed an exceptional balance of payments performance. Exports bounded upward as world market prices for its agricultural exports boomed and overseas sales of manufactured goods expanded rapidly. In 1973, exports rose by 55% to \$6.2 billion. Imports increased 42% to \$6.8 billion. In recent years, substantial and rising foreign investment inflows have offset large current account deficits. In 1973, the balance of payments surplus exceeded \$2 billion. Gold and foreign exchange reserves, as a result, have risen rapidly reaching \$6.4 billion at the end of 1973, sufficient to finance nearly 70% of 1974's projected imports.

32. Increased petroleum costs will have a substantial impact on the balance of payments. Higher oil prices and the expected expansion of other imports may boost the total import bill by over 35%, to a projected \$9.2 billion. Without the windfall price increases of recent years, exports are expected to expand by only 20%, reaching about \$7.2 billion.

The 1974 trade deficit of about \$2 billion would be more than triple last year's deficit. Continued increases in raw material, intermediate, and capital goods imports are essential if Brazil's rapid expansion is to continue. Large factor payments abroad will contribute to the current account deficit estimated at \$2.5-\$3 billion, up from \$1.4 billion in 1973. Turmoil in international investment circles may reduce foreign direct investment and other capital inflows to levels that would not totally offset the current account deficit thus causing a moderate balance of payments deficit during 1974. Government authorities would probably be willing to draw down foreign exchange reserves to finance a moderate balance of payments deficit.

33. Despite higher oil prices, the Brazilian economy should continue to grow at a brisk pace, although at somewhat below the 1973 rate. Economic growth is projected at about 8%-9% in 1974, compared with 11.3% last year. Slower growth largely reflects smaller imports and government efforts to reduce inflationary pressures that were noticeable before the recent rise in oil prices. Higher prices, however, will add to the downward pressure on growth. Even with deflationary measures, inflation is expected to exceed the 16% registered in 1973.

Brazil

Balance of Payments Summary

Million US\$

	<u>1972</u>	<u>1973</u> <u>Estimated</u>	<u>1974</u> <u>Projected</u>
Exports (f.o.b.)	3,990	6,200	7,200
Imports (c.i.f.)	-4,775	-6,800	-9,200
Trade balance	-785	-600	-2,000
Net services	-160	-100	-200
Net factor income	-515	-600	-725
Current account balance	-1,460	-1,300	-2,925
Capital account balance	3,560	(3,500	2,425
Errors and omissions	395	(
Net change in foreign exchange reserves (increase -)	-2,500	-2,200	500

Chile

34. The rise in world oil prices will boost Chile's oil import costs by some \$280 million above 1973's bill. The estimated \$400 million that Chile will have to pay in 1974 will equal more than 20% of projected 1974 export earnings. This increase probably will nullify the improvement Chile had hoped for in its trade balance and contribute to a deficit about equal to the 1972 level.

35. The junta which overthrew the Allende regime in 1973 inherited an economy in shambles. Both copper and agricultural output, the mainstays of Chile's economy, had declined, and the balance of payments registered a deficit of \$900 million in 1972. The trends remained the same for much of 1973, but some improvement occurred after the junta took over and by the end of the year, the deficit totaled only \$255 million. The improvement was due to increased exports and large capital inflows.

36. The impact of world oil shortages and higher prices may seriously affect the Chilean economy in addition to the increased costs of oil. Prior to the price rise, Chile's balance of payments prospects were expected to improve considerably. Agricultural output probably will increase, reducing the level of food imports. Copper production was set to rise from 650,000 tons in 1973 to 800,000-900,000 tons in 1974. Any slow down in world industrial activity

will adversely affect copper output and prices. A decline of 10 cents a pound for copper on the world market, for example, represents a loss of \$160 million in Chile's export earnings.

37. Chile's prospects for obtaining foreign credits to cover agricultural and capital goods imports appear good in 1974. However, while some of the funds can be used to pay for increased oil import costs, much of the credit has been tied. Private US and Canadian sources have extended some \$200 million in short-term credit. Additional credits totaling some \$450 million from Chile's Latin American neighbors are currently under negotiation. Estimates for the 1974 balance of payments deficits of \$250-\$500 million are based on the assumption that substantial debt service payments during 1974 will be reduced by 95% at the February Paris Club meeting.

Chile

Balance of Payments Summary

	Million US\$		
	<u>1972</u>	<u>1973</u> <u>Estimated</u>	<u>1974</u> <u>Projected</u>
Exports	858	1,171	1,563
Imports	-1,432	-1,519	2,149
Net services	-133	-34	-36
Net remittances	--	-79	-121
Current account balance	-707	-461	-743
Movement of capital	-201	206	234
Net change in foreign exchange reserves (increase -)	+908	+255	+509

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Selected South American Economic Indicators

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	Oil Consumption (barrels per day)	Oil as a Share of Total Energy Consumption (percent)	Oil Imports as a Share of Total Oil Consumption (percent)	
	1973 (estimated)	1973 (estimated)	1973 (estimated)	1974 (projected)
Argentina	487,000	91	14	15
Bolivia	14,000	60	2	N.A.
Brazil	750,000	46	75	80
Chile	136,000	82	74	N.A.
Colombia	120,000	50	0	N.A.
Ecuador	22,000	50	100	100
El Salvador	4,000	84	100	100
Guatemala	100,000	65	40	N.A.
Honduras	35,000	N.A.	100	100
Venezuela	228,000	90	0	0

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